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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 002841

SIPDIS

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SUBJECT: SERBIAN EMBASSY SAYS "DIFFICULT NEGOTIATIONS"
STILL AHEAD ON DEAL WITH GAZPROM

REF: A. MOSCOW 251

[1](#)B. BELGRADE 966

[1](#)C. BELGRADE 929

[1](#)D. BELGRADE 93

Classified By: Econ MC Eric T. Schultz for Reasons 1.4 (b/d)

SUMMARY

[1](#)1. (C) Serbian Embassy Counselor Boris Sekulic told us September 16 that his government expects "difficult negotiations" with Gazprom over its planned purchase of 51% of Serbian oil and gas monopoly NIS and the construction of the South Stream gas pipeline over Serbian territory. Sekulic maintained, however, that the linked deals will likely move forward as they "are important to both countries." The main issue regarding the NIS sale is an independent valuation indicating Gazprom's offer is 700 million euros short. As for South Stream, Sekulic said his government will insist on expanded capacity to make it a more attractive project for Serbia. End summary.

"DIFFICULT NEGOTIATIONS" AHEAD

[1](#)2. (C) Serbian Embassy Counselor Boris Sekulic told us September 16 that the meetings of the Russia-Serbia Economic Cooperation Commission lead by Russian Emergency Minister Shoygu will include negotiations on Gazprom's proposed purchase of 51% of Serbian oil and gas monopoly NIS and the future of the South Stream gas pipeline. Sekulic said the delegation includes representatives of Gazprom and its oil subsidiary, Gazpromneft.

[1](#)3. (C) With the recent approval of the broad deal (reftels) by Serbia's parliament, the two sides can now move forward with details. According to Sekulic, the agreement with Gazprom has four basic elements: a purchase of 51% of NIS by Gazprom for 400 million euros plus 500 million euros of investment by Gazprom in Serbia; the construction of a branch of the South Stream gas pipeline over Serbian territory; a joint-venture to develop gas storage capacity in Serbia; and expansion of Serbia's gas transmission and distribution network.

[1](#)4. (C) Sekulic predicted "difficult negotiations" ahead but was confident that some arrangement would be reached because the agreement is important to both countries. The difficulties would stem from a recent 2.2 billion euro

valuation of NIS by consulting firm Deloitte. The Gazprom offer was thus 700 million euro less than the value of the 51% stake it seeks. He said the GOS has drawn up a list of potential counter offers to make to Gazprom, such as selling Gazprom just 49% of NIS instead of 51% or having Gazprom buy Serbia's petrochemical company for 700 million euros. He expected Gazprom to rebuff both proposals but said the deal cannot go forward without "some compensation" for the shortfall in the price of NIS.

15. (C) According to Sekulic, selling NIS to Gazprom would give Russia's monopoly gas exporter monopoly control over Serbia's oil sector. However, he was hopeful that this situation would last only until Serbia joined the EU and, as a result, opened up its domestic markets to competition.

SOUTH STREAM

16. (C) Sekulic said that for Serbia, South Stream is critical to the deal because of the economic benefits it will bring. He said the GOS estimates Serbia could receive annual transportation tariff revenues of up to 200 million euros from South Stream. Noting that Serbia currently relies on gas from Russia through Hungary, Sekulic added that South Stream would also bring the benefits of an alternate gas route while helping to gasify Serbia's southern regions.

17. (C) However, one glitch with regard to the South Stream part of the deal, according to Sekulic, will be that Serbia will insist that South Stream's capacity on Serbian territory

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be expanded from the planned 10 billion cubic meters (bcm) to between 15 and 18 bcm. He suggested that Serbia might not be willing to go ahead with South Stream without this expansion because "experts" have determined that a minimum capacity of 15 to 18 bcm is required to make the pipeline profitable for Serbia.

COMMENT

18. (C) Gazprom will likely have similarly contentious negotiations on South Stream details with all of the countries through which the project will pass. This is even before starting the potentially more complicated and time consuming process of gaining popular buy-in and regulatory approval in each country. Gazprom claims it "has the gas" to fill South Stream but the project will require more than just gas to be built; it will need to be proven to be commercially viable as well.

BEYRLE